

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: McClintock, et al. Analyst: LuAnna Hass Bill Number: SCA 16
Related Bills: See Legislative History Telephone: 845-7478 Introduced Date: April 17, 2002
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Appropriations Limit/FTB And Controller Facilitate Timely Issuance Of Tax Rebates

SUMMARY

This measure would require the Franchise Tax Board (FTB) and the State Controller to issue rebates of any revenues received by the state in excess of the amount appropriated by the State during the fiscal year.

This analysis will not address the measure's changes to the other provisions of the California Constitution regarding appropriations, bonded indebtedness, and school districts, as they do not impact the department or state income tax revenue.

PURPOSE OF THE BILL

According to the author's staff the purpose of this measure is to create a process to return excess revenue to taxpayers via the income tax system instead of a sales tax rebate.

EFFECTIVE/OPERATIVE DATE

This measure would become effective and operative the day following approval by the voters in the next general election, which would be November 5, 2002, if such approval occurs.

POSITION

Pending.

ANALYSIS

STATE LAW

Under the California Constitution, the voters of the State have the authority to approve or reject any amendments to the State Constitution. Private citizens or groups can initiate amendments or the Legislature may place an amendment on the ballot if the proposal passes each House by a two-thirds vote. The Legislature proposes amendments to the California Constitution by passing a Senate Constitutional Amendment (SCA) or an Assembly Constitutional Amendment (ACA). Neither an SCA nor an ACA require the approval of the Governor. After the Legislature approves an SCA or ACA by two-thirds vote, it is assigned a proposition number and placed on a statewide ballot for the voters to approve or reject the proposed change. Any amendment to the Constitution proposed by the Legislature and adopted by a majority vote of the people takes effect the day after its adoption.

Board Position:

_____ S	_____ NA	_____ NP
_____ SA	_____ O	_____ NAR
_____ N	_____ OUA	_____ <u>X</u> PENDING

Department Director

Date

Gerald H. Goldberg

6/4/02

Existing provisions of the California Constitution prohibits a government entity's annual appropriation from exceeding its annual limit, which is adjusted annually for the cost of living and population changes. Currently, 50% of the excess revenues that are received by the State in a fiscal year, which is in excess of the amount that may be appropriated by the State for that same fiscal year, are transferred to the State School Fund. The remaining 50% of the excess revenues must be returned by the State by revising tax rates or fee schedules within the next two subsequent fiscal years.

THIS BILL

This measure would require that all excess funds received by the State in a fiscal year in excess of the amount appropriated by the State be held in a rebate account. At the end of each fiscal year, the funds in the rebate account would be rebated to California taxpayers on a pro rata basis. The rebates would be issued to persons, corporations, or other entities that paid taxes on, or measured by, income for taxable years that began during the prior calendar year. FTB and the Controller would be authorized to jointly take any necessary actions that would facilitate the issuance of timely rebates. This measure would be self-executing, meaning the rebate process would begin once the State has realized the appropriate excess revenues. Enabling legislation would not be required, but legislation may be enacted to facilitate the operation of the rebate process, so long as the legislation does not conflict with this measure.

Similarly, for each fiscal year all excess revenues received by an entity of government other than the State would be returned on a pro rata basis that would be established in advance by the governing body of the entity. The excess revenues must be returned within 30 days of the close of the fiscal year.

IMPLEMENTATION CONSIDERATIONS

The Revenue and Taxation Code requires FTB to administer and enforce the income tax laws. This constitutional amendment generally would require FTB and the Controller to oversee the issuance of rebates. Future enabling legislation would not be needed for the issuance of rebates if the voters pass the proposed constitutional amendment and the State receives excess funds subject to rebate under this measure.

Department staff has identified the following implementation considerations for purposes of a high level discussion; additional concerns may be identified as the measure moves through the legislative process. In order for FTB to implement this measure, clarification should be provided for at least the following issues:

- Clarification of the phrase "pro rata basis." Under this measure, funds must be rebated to California taxpayers on a pro rata basis to persons, corporations, or other entities that paid taxes on, or measured by income. It is unclear what specific criteria or measures FTB would use to determine the pro rata share of rebate for each taxpayer. The following are a few of the questions that should be addressed:
 - Would the rebate amount be based on factors such as total income or total tax?
 - Would there be a minimum or maximum rebate amount?
 - Would the rebate amount for taxpayers who are married and filing a joint tax return be twice the amount of a rebate for an individual taxpayer?

- This measure requires excess funds received by government entities other than the State to be returned within 30 days. However, this measure does not provide a specific deadline for the State to issue rebates of excess funds.
- Could rebate payments be revised after issuance? Depending on the factors determining the pro rata rebate amount, certain circumstances could result in rebate revisions. These factors include the receipt of amended returns, audit adjustments, or processing errors.
- How will offsets to FTB, the Internal Revenue Service, and other State agencies be handled? Currently, these agencies participate in an agency-offset process where refunds are offset to satisfy an outstanding liability owed by the taxpayer to another government entity. Since this is a rebate of excess state revenues as opposed to a refund of taxes, clarification would be needed on whether these rebates would be subject to the agency-offset process.

In addition, if FTB were responsible for issuing the rebates as proposed by this measure, the department would need to create a new system for issuing and processing the rebates. This measure does not include an appropriation to cover the costs of developing a system for issuing and processing the rebate. Without an appropriation the department would be required to redirect resources from revenue producing activities to implement this measure.

LEGISLATIVE HISTORY

ACA 22 (J. Campbell, 2001/2002), which is similar to this measure, would require FTB and the State Controller to issue rebates of a portion of the revenues received by the state in excess of the amount appropriated by the State during the fiscal year. This measure is with the Assembly Rules Committee.

A version of AB 2869 (Machado, Stats. 2000, Ch. 977) prior to enactment would have authorized a sales and use tax rebate to qualified taxpayers of \$50 or a variable amount based on the taxpayer's filing status and federal adjusted gross income. This provision was removed from the bill.

AB 2609 (Stats. 1987, Ch. 915) and SB 47 (Stats. 1987, Ch. 908) authorized a tax rebate of excess funds for the 1986 taxable year. Qualified taxpayers were allowed a tax rebate of 15% of the tax imposed by the income tax law, as defined, with specified minimum dollar limits and maximum dollar limits. The rebate was calculated and administered by FTB and required rebate checks to be sent by the Controller to taxpayers by January 15, 1988.

OTHER STATES' INFORMATION

A review of the state laws and Constitutions of *Florida*, *Massachusetts*, *Michigan*, and *Minnesota*, found the following:

- *Florida* and *Minnesota* require excess revenues to be refunded to the taxpayers.
- *Massachusetts* allows a credit, called the "excess revenue credit," toward taxpayers' personal income tax liabilities.
- *Michigan* requires excess revenue to be refunded on a pro rata basis that is based on the liability reported on the Michigan income tax and single business tax returns.

A review of *New York* and *Illinois* state laws and Constitutions did not produce any information regarding procedures for excess revenues. The laws of these states were reviewed because of similarities to California income tax laws.

FISCAL IMPACT

The department's costs to administer this measure cannot be determined until implementation concerns have been resolved but are anticipated to be significant. At a minimum, the department would need to implement a system to calculate and issue the rebates proposed in this measure.

ECONOMIC IMPACT

This measure would not impact personal income tax and corporate tax revenues.

ARGUMENTS/POLICY CONCERNS

The rebate of excess State revenue could be accomplished more efficiently through a change in 1) tax rates, 2) taxable income brackets, or 3) the standard deduction. A special tax credit that could be claimed on the ensuing year's tax return also could be effective. However, a change in the tax rates, income brackets, or standard deduction would benefit fewer taxpayers because only those with the applicable taxable income would realize the savings. On the other hand, a special refundable tax credit may cause the State to pay out more in refunds than is available in excess revenue because an increase in fraud is generally associated with refundable credits.

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